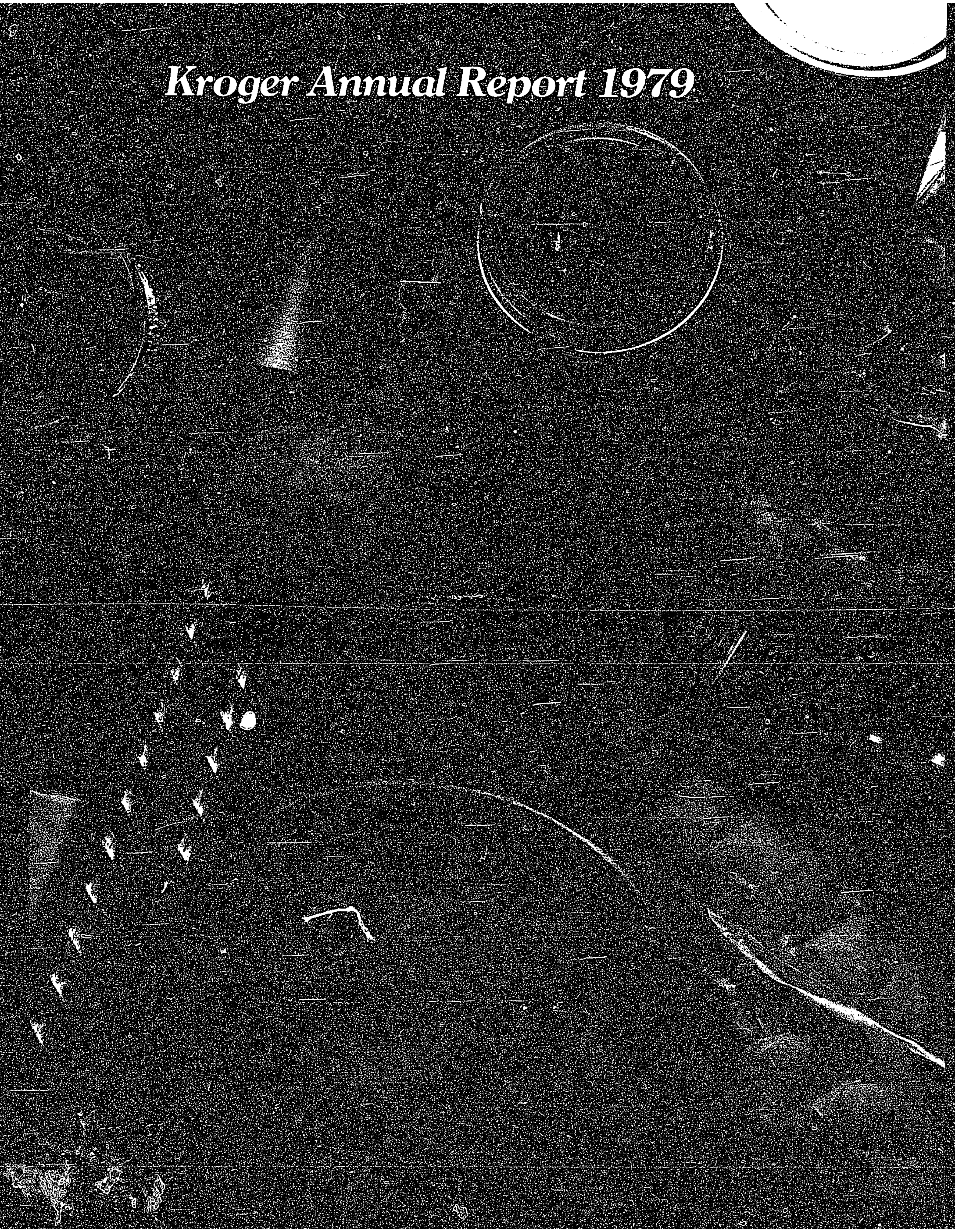
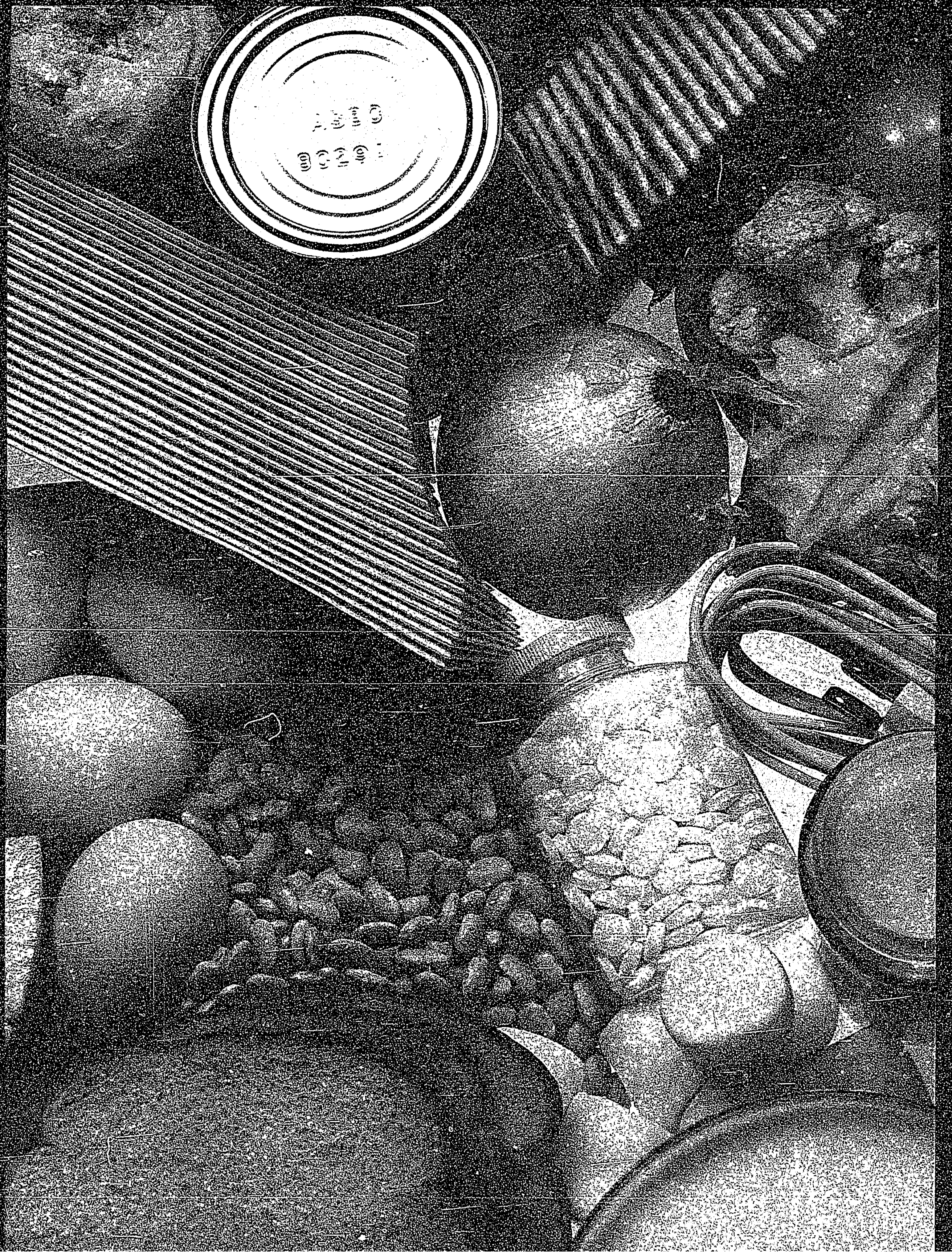
Kroger Annual Report 1979





Highlights

THE KROGER CO. is the second largest food retailer in the United States, operating 1,234 food stores in 21 states, primarily in the area between the Great Lakes and the Gulf of Mexico, as well as in southern California. Extensive food processing facilities, including dairies, bakeries, egg facilities and plants producing other products, serve the food stores. The SupeRx drug store division operates 504 drug stores in 21 states, most located in Kroger states but also in other states in the east, south-east and southwest. Through joint ventures, the Company owns and operates theme amusement parks in Virginia, North Carolina and California. Headquarters are in Cincinnati, Ohio, where Kroger was founded in 1883.

Contents

Financial Highlights

	1979	1978	**Change**
Sales	**$ 9,029,314,683**	$ 7,828,071,073	+ 15.3%
Net Earnings			
LIFO	**$ 85,720,819**		
FIFO	**$ 105,515,860**	$ 84,596,086	+ 24.7%
Dividends Paid	**$ 34,524,436**	$ 24,217,754	+ 42.6%
Shareowners' Equity	**$ 611,328,222**	$ 554,507,066	+ 10.2%
Per Common Share			
Net Earnings			
LIFO	**$ 3.13**		
FIFO	**$ 3.85**	$ 3.11	+ 23.8%
Dividends	**$ 1.26**	$ .89	+ 41.6%
Shareowners' Equity	**$22.14**	$20.34	+ 8.8%

To Our Fellow Shareowners:

The Kroger Co. in 1979 achieved another successful year — continuing to reflect the results of our substantial investment in the modernization of our Company over the past several years.

In 1979, we returned to the LIFO (Last-In, First-Out) method for valuing grocery inventories. While this accounting method reduces reported earnings, it also has the positive effect of conserving cash for investment in the business rather than paying it out in taxes for inflation-induced inventory profits. We believe this is a prudent step that will be an important factor in providing capital for our long-term expansion plans in an era of tight and expensive capital financing. Earnings information for 1979 has been furnished on both a LIFO and FIFO (First-In, First-Out) basis so that direct comparisons of 1979 versus 1978 performance can be made.

Sales of $9.029 billion in 1979 rose 15.3% over 1978. Net earnings for the year 1979 were $85.7 million on a LIFO basis or $105.5 million on a FIFO basis, compared to $84.6 million (FIFO) in 1978. Earnings per share were $3.13 (LIFO) in 1979 and $3.11 (FIFO) in 1978. On a comparable FIFO basis in both years, earnings per share increased 23.8% to $3.85. The 1979 LIFO charge totaled $19.8 million or 72¢ per share.

During 1979, we continued the policy of rewarding shareowners with dividend growth. The quarterly dividend was increased 36% during the year — rising from 25¢ to 29¢ per share in March and to 34¢ per share in September.

1979 Year of Growth and Challenge

During 1979, Kroger was able to perform better than most in the retail food industry — reflecting both the results of our $750 million modernization of the Company, primarily for retail facilities, and our merchandising approach, which is constantly evolving in response to the needs of the consumer.

Early in 1979 Kroger benefited from a number of factors. For example, we believe the springtime gasoline shortage encouraged shoppers to patronize stores such as Kroger, where they can purchase the greatest amount of their weekly shopping needs with one stop.

In the second half of the year, the impact of unabated high inflation and the recession caused shoppers to buy more cautiously. This, coupled with increased operating costs, also created a more competitive climate.

The experience of the factors affecting retailing in 1979 has confirmed once again the strength of the Kroger of today. Our stores are modern. Our strategy of store development fits compatibly with the energy situation which confronts our country. We offer the convenience of one-stop shopping. And in an era of shopping for the best bargain, we are committed to providing honest, dependable food shopping service which consumers can trust with confidence.

A growing number of consumers are discovering that Kroger is a good place to shop — there were 39 million more customer transactions in 1979 than in the prior year.

The year 1979 was one of progress in more than sales and earnings. It also was another year of progress in building the asset base of the Company. Capital expenditures totaled $177 million. We opened 88 new food stores and remodeled 91, adding 1.8 million square feet of retail space. The number of stores rose for the third consecutive year, from 1202 to 1234 food stores.

Kroger Food Processing

Our food processing operations represent a key part of Kroger results. In 1979, we spent approximately $38 million to maintain and expand our production capacity. The Minnesota cheese plant and the Columbus bakery have been enlarged and expansion of the delicatessen plant is under way. We are now operating a dairy in Virginia, a bakery in South Carolina and an egg-breaking and processing operation in Illinois.

In 1980, construction will begin on a new dairy in Tennessee. A frozen dough plant in Kentucky — which will supply in-store bakeries with basic doughs to be made into fresh store-baked products and will produce a line of hearth-baked breads and rolls — will be under way. A new cottage cheese whey conversion plant, the first of its kind in the world, also will begin construction in Indiana in 1980.

One of Kroger's inherent strengths is our ability to produce high-quality private label products that compete favorably with national or regional brand products. Kroger Food Processing has grown with our food stores and has contributed to their growth. In 1979, Kroger products continued to outpace overall growth in our stores in those categories in which they compete — a tribute to the combination of quality and price provided by Kroger brands...and to the wise shopping sense of consumers, who respond to a value.

SupeRx Drug Stores

We were not pleased with the results of the SupeRx drug store division in 1979. The sales pace during the second half was slower than anticipated and operating expenses accelerated. Promotional efforts to improve sales were expensive and insufficiently productive. We are confident that

SupeRx will in the long range recover sales and achieve satisfactory earnings, but it will require work and patience.

SupeRx today is facing much the same kind of problems that the food stores experienced in the late '60s and early '70s prior to their modernization. We are developing a SupeRx real estate program to provide a clear pattern of growth and development and to enhance SupeRx' ability to operate efficiently. And we are sharpening the focus of SupeRx' image as a provider of a wide range of health care products and services for the family. Results in test stores indicate that we are on the right track.

In 1979, we opened 24 new drug stores and acquired 14 stores in Florida. A total of 40 new drug stores is planned for 1980. In addition, 25 stores will be remodeled to reflect SupeRx' new merchandising approach.

New Directors

Russell L. Wagner, Chairman of the Board and Chief Executive Officer of NLT Corporation of Nashville, Tennessee, and William D. Atteberry, Chairman of the Board and Chief Executive Officer of Eagle-Picher Industries, Inc., of Cincinnati have been elected Kroger directors. William W. Boeschenstein, after more than 14 years of valuable service, has resigned as a director for business reasons.

1980—Year of Opportunity

During 1980, our capital plans call for the investment of approximately $200 million in the continuing program to keep Kroger modern and efficient.

We plan to open 120 new and 52 remodeled food stores during the year, representing three million square feet of additional retail space and bringing us at the end of 1980 to approximately 35.5 million square feet of food store space, up 38% since 1972.

Most of these stores will be in the range of 30,000 to 40,000 square feet and will include the popular features which are a proven sales attraction for shoppers. Kroger is probably the largest operator of in-store deli/bakeries in the country today, with a total of 840 at the end of the year. Many of our stores also have free-standing cheese shops, offering 120 varieties of cheese, or floral shops with both plants and cut flowers.

We are convinced more firmly than ever that the fundamentals of what we are doing with regard to stores, emphasis on perishable products, low competitive pricing and specialty departments all fit well into the needs of the customers we are serving and the environment in which we will be doing business in the 1980s. We have built solidly.

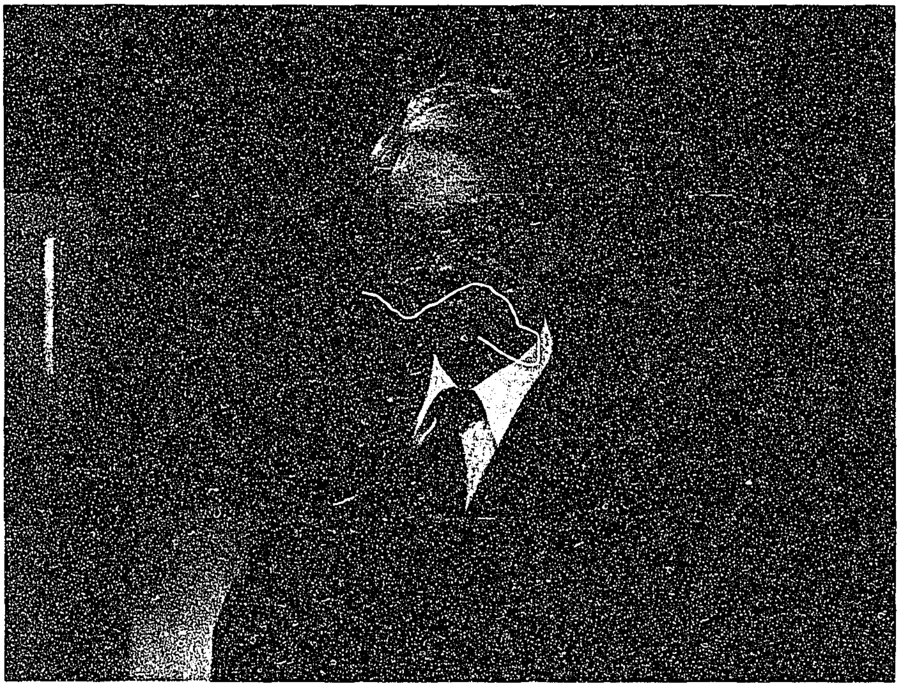
There is a basic strength and integrity about the approach we have chosen, and while adjustments may be made from time to time to meet changing circumstances, the foundation remains constant.

The external influences that affected all business in 1979 – the uncertainties of the economy, high inflation and the international situation – will not disappear in 1980. We are mindful of these factors, but we move into 1980 with confidence in Kroger's ability to produce another successful year for our shareowners. We have planned well and our plan works. And importantly, serving our shoppers well is enabling us to serve our shareowners better.

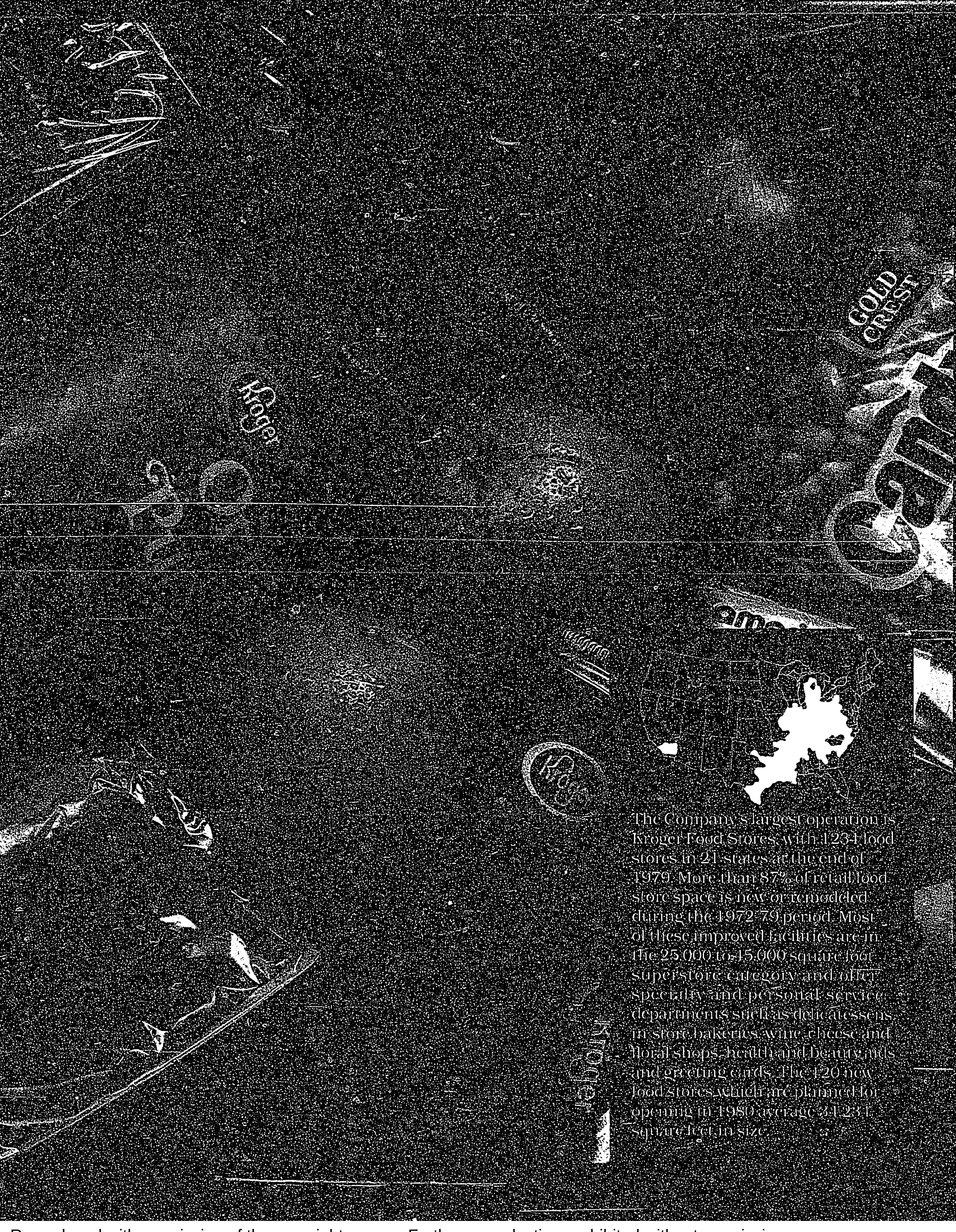
Sincerely,

Lyle Everingham

Chairman of the Board
and President



Kroger Food Stores

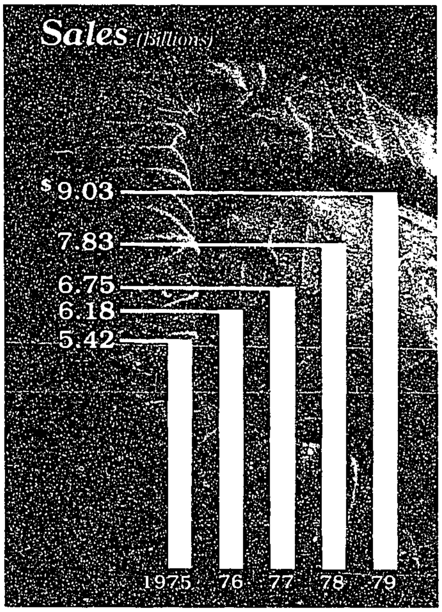


The Company's largest operation is Kroger Food Stores, with 1,234 food stores in 21 states at the end of 1979. More than 87% of retail food store space is new or remodeled during the 1972-79 period. Most of these improved facilities are in the 25,000 to 45,000 square foot superstore category and offer specialty and personal service departments such as delicatessens, in-store bakeries, wine, cheese and floral shops, health and beauty aids and greeting cards. The 120 new food stores which are planned for opening in 1980 average 31,234 square feet in size.

Earnings were up significantly during the first half of 1979 but moderated in the final two quarters. What caused this slowdown?

The moderation resulted mainly from a slowing in sales, lower gross margins, acceleration in operating costs, and the disappointing performance of the drug stores.

Earnings increased rapidly in the first half as we gained sales and customers purchased more high-



markup items. The gas shortage encouraged one-stop shopping and stay-at-home consumption. And there was some hedge buying in anticipation of problems from weather or work stoppages. As we moved into the second half, economic conditions turned down in some of the areas we serve and inflation continued to climb. As a result, many shoppers began trading down to less expensive items and bought less. Customers purchased less beef and more poultry and pork and many switched from national brands to other more economical items. This means that more units have to be sold to achieve the same dollar sales (and thus it costs more to handle the products).

The supermarket business was hit hard in the 1973-74 recession. Now there is talk of another one, with many major industries (automobiles, steel, coal, housing) reeling from the impact. What effect do you see on Kroger?

Obviously, we have seen and will continue to see a combination of more cautious spending by consumers and the competitive situation resulting from the scramble for sales to balance the continued rise in operating costs and to produce a profit.

Kroger's situation, however, is quite different than it was in 1973-74. At that point, we were just beginning our building program and still had a large number of older, smaller stores, which were not only less efficient to operate but which could not be merchandised properly to reach a wide number of shoppers.

Today, while we are not immune to the factors that are affecting business, Kroger is better equipped than most to compete in this atmosphere. This does not mean that sales come easily at a time like this for Kroger. We have to work hard for every dollar and every customer. We have managed not only to keep our customers but to win new ones – with 39 million more customer transactions in 1979 than in 1978.

More than 87% of Kroger stores are new or remodeled since our modernization program began in 1972. Our merchandising programs reflect our shoppers' wants and needs. Our manufacturing operations have grown with the needs of our stores. And our training programs have been stepped up to prepare our people for their expanded responsibilities. Kroger's strengths are especially productive in meeting the needs of consumers for one-stop-shopping in an energy-short era.

While we believe Kroger is in a good position to cope with the factors affecting retailing, we do expect 1980 to be a very challenging year.

Kroger has stated that the impact of inflation and the recessionary period have caused many shoppers to alter buying patterns to stretch their food dollars... in other words, to buy less expensive items and cut out non-essentials. Why, then, does Kroger continue to put such departments as cheese shops, deli/bakeries and flower shops in stores?

We have also noted that there are conflicting patterns in food shopping today. Many people are definitely feeling the pinch of inflation and responding by trading down and cutting back on purchases. Kroger offers them a variety of choices to fit each income level – all nutritious but some providing a less fancy product in the interest of saving money. We have national and regional brand products. Kroger brand products are targeted to leading national brands in quality, while other brands, such as Avondale, are less fancy. We have beef for those who want it, but also poultry and pork if that's the preference. The wide choice Kroger offers consumers is one of the reasons our Company has continued to attract new shoppers.

On the other hand, the service specialty departments also are doing extremely well because they meet a different set of needs. The time saved by purchasing prepared foods from the deli, for example, may be essential to a working mother who likes to feed her family well. And she can probably do it more economically at Kroger than at a fast-food outlet. Then, too, there are many consumers who are more affluent than ever before and who are trading up (and even those who forego steak may gain a sense of luxury from a sampling of an unusual cheese).

Kroger stores, in other words, are designed to serve the needs of a wide group of food store shoppers... not just one type consumer... and to do it pleasantly and profitably.

In October, Kroger announced plans to return to the LIFO accounting method for valuing grocery inventories. Why make the switch? Won't it result in lower profits?

There were a number of reasons for returning to the LIFO method at this time. It will conserve cash and allow greater comparability with other companies in the food retailing field. (At the time FIFO was adopted in 1973, most leading food retailers used that method – many since have switched to LIFO.) It also will minimize inflation-induced inventory profits and achieve a better match of current costs with current revenues.

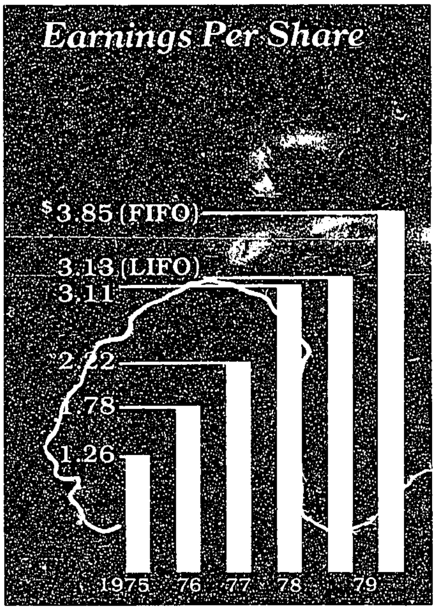
The overwhelming reason that makes this move advantageous for the Company and its shareowners is the fact that use of the LIFO method will allow us to retain cash for investment in the business rather than paying it out in taxes. In a time of short and expensive capital, we believe this makes good sense.

You state that the move to LIFO will benefit shareowners, even though it will reduce reported profits. Shareowners have another interest, though, and that is the effect on dividends. You stated in last year's report that the dividend rate at that time was about 37% of 1978 earnings. How will LIFO affect the dividend policy?

There will be no change, except that on the basis of reported earnings, the move will serve to increase the *percentage* of earnings paid out for dividends. For example, the current $1.36 annual rate represents more than 43% of 1979 earnings on a LIFO basis and about 35% on a FIFO basis.

Dividends will continue to be established on the basis believed to be most advantageous to shareowners in the long run. The Board of Directors will balance the current level of profitability and the prospects for the future, as well as capital needed for growth, in deciding on dividend payments.

We believe that our shareowners' return on their investment in the Company deserves to grow with the Company. In 1979, the dividend rate was increased 36% – from 25¢ a share per quarter ($1.00 on an annual basis) to 29¢ per quarter or $1.16 annually in March, and to 34¢ quarterly or $1.36 annually in September. The $1.26 per share paid in 1979 increased 41.6% from 1978 dividends paid of 89¢ per share.



More and more, the recommendation is being made that corporate Boards of Directors be made up primarily of outside directors. Kroger appears to have reached this objective. How is it working out?

The modern corporate Board of Directors is an active, working Board which is expected to represent the shareowners' interests in any discussion of management proposals.

Kroger is fortunate to have that kind of strong Board of Directors. The only inside director is the Chairman, and directors were carefully chosen for a broad balance of knowledge and experience. The Kroger Board of Directors includes Chief Executive Officers and Presidents from national and international companies with interests in such areas as banking, retailing, manufacturing, railroading, natural gas and oil, financial services, insurance and broadcasting, in addition to educators. Our retired Chairman, James P. Herring, also serves on the Board. The age spread also represents a good balance – ranging from 45 to 68.

At Kroger, we believe this kind of Board is particularly helpful – we already have the benefit of the counsel of inside executives, and this allows us to receive the insight and expertise of leading executives from other companies and organizations.

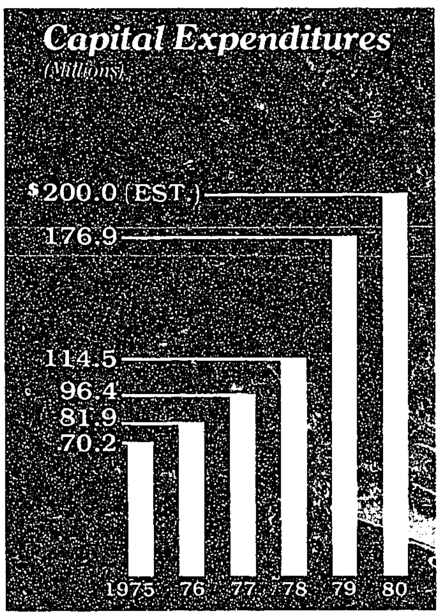
As also has been recommended, we have Audit, Nominating, Compensation and Corporate Responsibility committees composed of outside directors – a Kroger policy of long standing.

Kroger's emphasis has been on developing stores in the areas where it presently operates. Do some of your geographical locations have greater potential than others? Do you plan any expansion outside your present operating area?

Our building program has been planned throughout to produce the maximum return on our investment. We first concentrated on building where we were established and would have the quickest turnaround on our investment. At the same time, we began a program of planning for adequate representation in each market in which we operated – a necessity if we were to

serve shoppers properly, afford the necessary support services and produce a profit. We still have a lot to do within the boundaries of our present operating area, but we are conservatively expanding into nearby locations.

We will continue to develop stores in the areas of the Midwest where we have long been established and successful. But we have also made a commitment to the strong growth areas of the South. About half the food store square footage developed in 1979 was in the South. This pattern will continue to hold true in 1980.



Our expansion to new markets is primarily contiguous to present operating areas so that new stores will benefit from the support of existing distribution services, management supervision and manufacturing facilities. Our growth in the Carolinas, however, is moving us into totally new areas of these states. In Texas, we recently announced plans to move into the thriving San Antonio market – not with one store at a time but with a group of stores (eight this year) along with support facilities.

The international situation and the need for the United States to become more independent of oil production outside its control has created a fuel shortage which will periodically or permanently restrict excessive driving. What effect will this have on Kroger?

There are two aspects to this question – how will the fuel shortage affect our own fleet and how will it affect shoppers.

From the standpoint of our own fleet, it will mean scheduling of truck runs even more carefully and maximizing loads to get full value from every gallon of diesel fuel used. We have been making an intensive effort to conserve fuel for several years – both in the public interest and because of our desire to control costs. Today we are not only saving miles but also getting more miles per gallon from our fleet. We are also urging government to correct artificial restrictions which cause excessive use of fuel (such as the backhaul restrictions about which we wrote shareowners in December). Fuel costs are still rising (the cost of diesel fuel increased 61.7% from the end of 1978 to the end of 1979) but our efforts are helping to hold down the rate of our total cost increase.

From the standpoint of impact on sales, experience during previous gas crunches indicates that more shoppers tend to patronize those stores which allow them to purchase the greatest number of their weekly needs with one stop – and the Kroger superstore certainly fills that bill. With its wide variety of products, the superstore offers customers the convenience they must have in a period of limited fuel supplies... without sacrificing the quality, service and low prices which also are of key importance to them.

Kroger says it is concerned about energy conservation. Yet nearly half of Kroger stores are open 24 hours a day and the trend appears to be toward round-the-clock operation. Couldn't you save a lot of energy if you operated shorter hours?

Yes, it is true that the trend in supermarket operation is toward longer hours. And no, we would not save energy by closing earlier.

Part of the move toward longer operating hours – particularly extended evening hours and Sunday operation – is a direct result of the growing needs of shoppers who find it difficult to shop during traditional daytime hours. For example, approximately half of married women are working outside the home and many must shop in the evening. Many other working women and men maintain households.

There are a substantial number of other people who like to shop when they come off night work shifts – or who for one reason or another prefer to shop at their leisure when the store is quiet. You may be assured that stores would not be open longer hours unless there was sufficient business to make it worthwhile.

As to energy-saving, there would be little or no energy saved if Kroger stores closed early. The major use of energy in a supermarket is for refrigeration and freezer equipment – which must operate to protect food 24 hours a day whether the store is open or closed. Some lights are necessary in either case so the night crew can stock shelves and clean the store, but all non-essential lighting is reduced to a minimum level at night. Some 60%

Food Processing Facilities

Kroger processes a number of products for sale in its stores, a tradition which began before the turn of the century. The Company operates eight bakeries and seven dairies in addition to a cheese plant, egg production facilities, egg grading and packing plants, a sausage plant, a peanut butter plant, a candy plant, a delicatessen kitchen, a pharmaceutical plant and a general processing plant where such products as coffee, tea, preserves, salad dressings, spices, nuts and other items are processed. Other private label products are prepared for sale in Kroger stores by leading food processors throughout the country.

of Kroger stores are equipped with heat reclaim systems which recycle the heat generated by the refrigeration equipment to provide heat and hot water for the store.

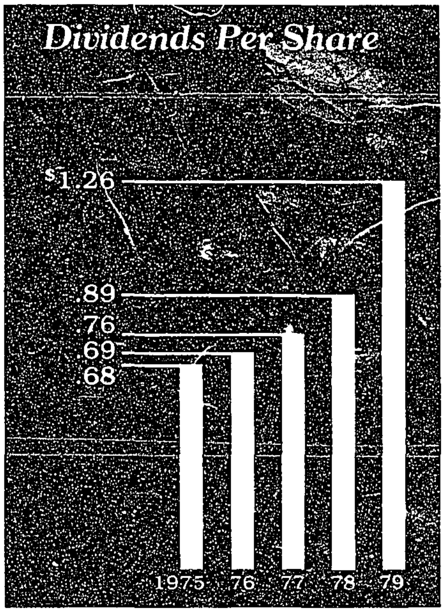
Incidentally, during some of the gas or electricity shortages of the past few winters, energy-conscious supermarkets such as Kroger were exempted from regulations controlling hours of operation because local governments found that not only would little or no energy be saved if stores closed...but customers would have had tremendous problems getting their food – both because of the fact that not everybody can shop at the same time, and because it was not physically possible to serve all the shoppers in limited hours.

Specialty departments, such as delicatessens, and customer services, such as bagging, are popular features of Kroger superstores – and certainly one of the important reasons for the success of the total store because of the friendly, service-oriented image they project. How can Kroger afford to have these personal services – particularly when you are competing with similar operations with lower operating costs?

Development of specialty departments and providing of other customer services that have become competitive factors – such as bagging – have been and will in the future be significant in forming customer perceptions of Kroger service.

One of the reasons we are able to offer these departments and services to shoppers is the effort of our Kroger people and the cooperation received from various segments of the retail unions which represent our store employees. Very often, our ability to provide service-oriented personnel depends on being able to compete equitably with similar operations in fast-food outlets or other food stores which may have lower wage levels and fewer productivity restrictions.

This cooperative effort is making it possible for us to serve consumers better and to increase sales. At the same time, it is providing opportunities for young people to enter the food business and be trained for productive careers. The number of Kroger employees is steadily increasing – up more than 11,000 in the past year to 118,449 at the end of 1979.



What are Kroger's capital spending plans and how will you finance those expenditures?

In 1980, our capital expenditures will total about $200 million, which will be typical of our continuing modernization program during the next few years.

This capital program will be financed out of retained earnings plus borrowings and various other financing, such as industrial revenue bonds. Also, the switch to LIFO accounting will make additional funds available for investment.

As we have done during our building period of 1972-79, we will continue to anticipate financing needs well in advance, but will keep our balance sheet ratios in line. A corporate objective will be to maintain the "A" rating we currently have from both Moody's and Standard & Poor's.

During our rapid expansion and modernization over the past several years, we have used anticipatory financing with good results. Our public borrowings have anticipated our needs as much as two years ahead. This has enabled us to maintain a planned momentum in all areas – and it has enabled us to obtain money at a lower cost.

Even though we are now able to finance a good portion of our capital program internally, we are cognizant of future plans and of prudent supplemental financing which may allow us to take advantage of profitable investment opportunities.

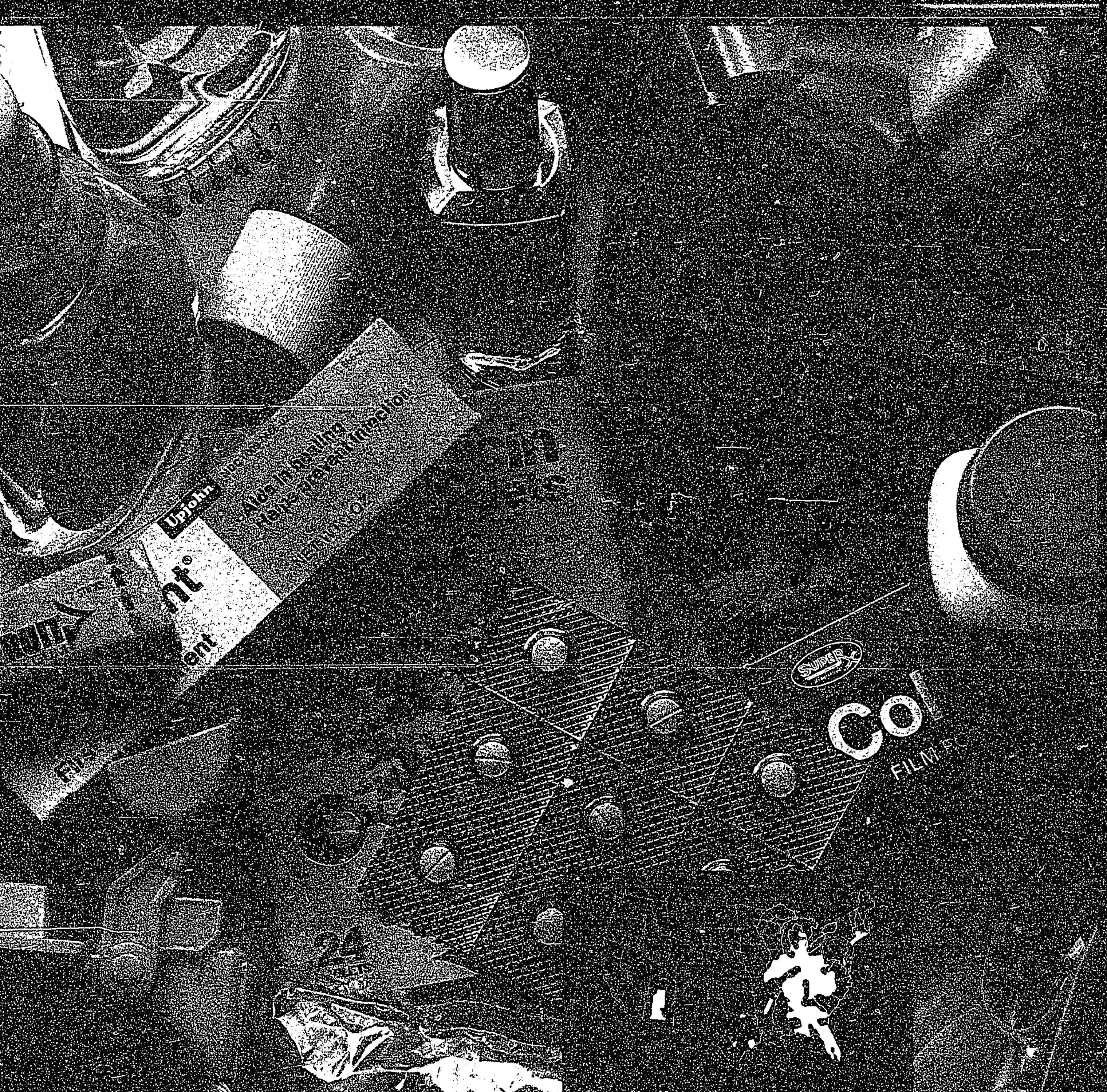
Kroger at the end of 1978 had only 11 scanner checkout system installations and in one year added 66. More than 100 are planned for 1980. Why has Kroger suddenly increased its interest in these systems? Do you eventually plan to install them in all your food stores?

At Kroger, we feel the time is now right for expansion of scanning – largely because the Universal Product Code (UPC) identification on grocery packages has now reached a level which makes scanning productive for consumers and allows us to achieve a level of output which makes the return on investment attractive.

The systems are already paying off in terms of sales increases, improved checker accuracy and productivity, and savings in the time used for store reports. Scanning is not only meeting our expectations, but has exceeded them so far. These savings are available now, and we can justify these systems on this basis alone.

We see other advantages in the future, and these further savings possibly represent the greatest potential in terms of merchandising, product movement analysis, and other research applications.

SupeRx Drug Stores



SupeRx Drug Stores, with 504 drug stores in 24 states at the end of 1979, is one of the country's largest drug store chains. Although SupeRx operates a majority of its drug stores in states where Kroger Food Stores are located, drug stores are also located in Arizona, Connecticut, Florida, New Jersey and New York.

Significantly, shoppers like the system and its informative receipts, which print out the name of the product as well as the price and other data. Scanners will become an increasing factor, not only in our ability to compete on the basis of efficiency but also on the basis of customer service.

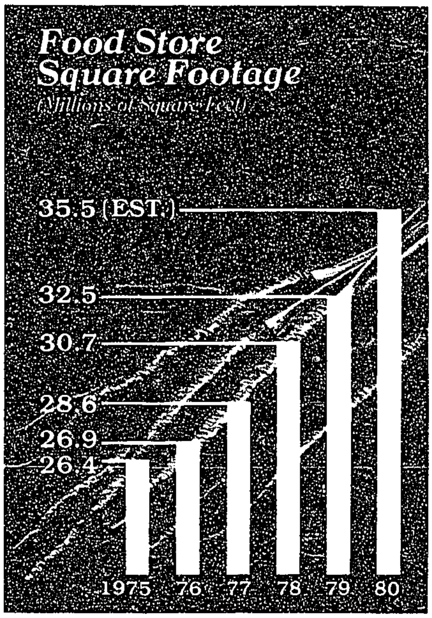
It does take a certain size store to support a scanner checkout system, so probably the time will not come in the near future when all stores will use scanning. However, we do plan to continue to expand use of scanners.

Your SupeRx drug store division started out 1979 as though it had turned the corner. What happened and what specifically are you doing to get SupeRx back on the track?

Some improvements had been made in SupeRx operations and merchandising. There was some progress for a time. However, priorities were not established clearly, the foundation on which SupeRx was building was not as solid as it should have been, and the challenges of competition and inflation were more significant than our assessment. Our problems did not result solely from high inflation and spiraling operating costs, but they were aggravated by these factors. It became evident that SupeRx stores were simply not efficient enough for today's economy and that they were not being merchandised in a manner consistent with today's shopper.

Accordingly, we made some difficult decisions, which have led to and are part of a stronger, more substantive change. We are implementing our program on an orderly, planned basis and we are monitoring results. We are giving the drug stores the same kind of hard scrutiny and research that preceded the modernization of the food stores. And we are forming certain conclusions regarding the kind of drug store that best suits today's shopper.

Most importantly, we found that SupeRx no longer enjoyed a strong health care image. We are taking steps to reestablish and reinforce the fact that SupeRx is a *drug store* and a total health care center. (...Just as our superstores, despite the wide variety of non-foods they carry, are clearly identified as a *food* store the minute the shopper walks in the door.)



The 1980s SupeRx store is being redesigned to reflect our commitment. Pharmacy remains the central focus of the store, and we are adding other departments which are health-related, such as optical centers staffed by a licensed optician, and a complete nutrition center, offering vitamins and natural foods. Other health care services will be tested in the future.

In addition, SupeRx will expand departments which have traditionally been part of a drug store – such as a sociability center with greeting cards, candles and wrappings...a convenience center providing party items such as ice cream, beverages and snacks... a large cosmetics department... and of course, photo-finishing, in many areas provided by our own laboratory. Variety in these departments has been widened and close attention will be given to making sure products are price-competitive.

The new SupeRx merchandising approach is being planned and implemented with the assistance of extensive consumer research. Listening to the consumer is just as important in a drug store as in a food store.

The results from the initial SupeRx drug stores which have been converted to the new merchandising concept are very encouraging.

It will take time to revitalize the SupeRx stores, and it will cost money. But as more and more drug stores become modernized into total health care centers, we anticipate a geometric progression of sales and earnings, just as we have seen in the food stores. We intend to proceed in an orderly, planned fashion towards the emergence of a strong, dynamic and profitable drug store division.

SupeRx opened its first distribution center in Florida in the spring of 1979. How is this working out? Do you plan additional distribution centers to serve other stores?

Integration of a distribution center operation into a drug store company which has since its beginning operated without warehousing is a major task. However, the Florida distribution center opened on schedule and is proceeding according to plan, now serving over 100 stores.

There are so many advantages (such as lower product and freight costs, lower inventories and other operating benefits) to operating through our own distribution centers that we not only believe that this is the way to go, but it is becoming evident that this is an important part of our total development of SupeRx.

Plans are being completed for a second SupeRx distribution center to start serving 200 additional stores during 1981. Eventually, most SupeRx stores will be served through similar centers.

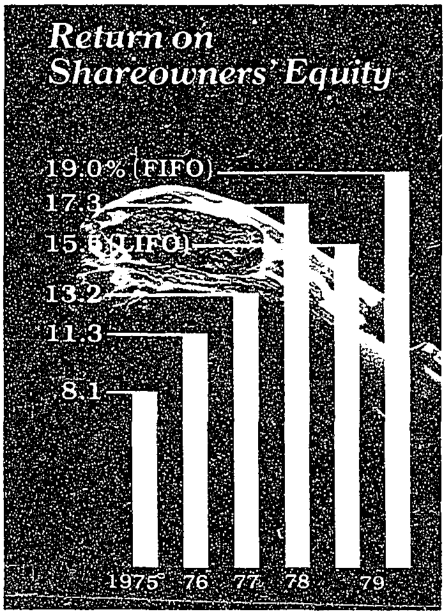
Kroger Food Processing has some unusual projects under way. How will the frozen dough plant and the cottage cheese whey conversion plant benefit Kroger?

Whenever Kroger decides to make an investment in our business, it is designed to accomplish a number of objectives . . . better quality control, more efficient operation, improved customer service . . . and in so doing, to enhance sales and profitability. There is very careful analysis and consideration before the "make or buy" decision is finally made. If we cannot do it better and more economically ourselves, we see no advantage either to Kroger or to our customers to produce the product internally.

For example, the basic dough which is converted into a variety of fresh-baked breads, rolls and pastries at in-store bakeries is presently being obtained from several different sources. The new frozen dough plant, when it is completed, will allow us to produce a consistent quality product to our own specifications, produce it more economically, and distribute it more efficiently — all of which can help us satisfy shoppers more fully.

The cottage cheese whey conversion plant is the first of its kind in the world . . . and an indication of the ability of our people to look beyond the obvious to solve problems and improve profitability.

Our food processing research team has developed a patented process for converting the whey which is left over from the production of cottage cheese into high-quality baker's yeast and protein. *What had been an expensive disposal problem for Kroger dairies now will become a usable asset for our bakeries, solving a troublesome ecological problem at the same time.*



In 1979 the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 33, Financial Reporting and Changing Prices, (SFAS 33) which requires companies to report the impact of inflation on earnings and assets (see page 25 and 26). What is the purpose of SFAS 33 and what does it mean to shareowners?

SFAS 33 is an experimental attempt by the Financial Accounting Standards Board to try to put some measurement on the impact of inflation in terms of earnings, cash flow and current value of a company's assets.

For 1979, companies must report "constant dollar" information based on inflation as measured by the Consumer Price Index. Opinions vary as to its usefulness. The Wall Street Journal reports that many experts fear that most investors will be thoroughly confused by SFAS 33 reporting. Further, the results may not be valid and may not be consistent from company to company. As a matter of interest, here are some of the things Kroger inflation-adjusted results show:

— Cash flow is unchanged.

— Taxes based on income as a percent of pretax earnings are substantially higher than the statutory 46% rate.

— The percentage increase in dividends per share from 1975 to 1979 has exceeded the increase in the rate of inflation for that period.

— Based upon constant dollar amounts, Kroger shareowners' financial interest in the Company is considerably greater than it appears from shareowners' equity on a historical cost basis.

Financial Report

Management's Analysis of Summary of Operations

This analysis of Company operations encompasses the years 1977, 1978 and 1979 and should be considered in conjunction with the Consolidated Statement of Earnings, page 17; Operating Results by Segments of Business, page 16; and the Five Year Summary, page 27.

Sales in 1979 of $9,029,315,000 were $1.2 billion or 15.3% ahead of 1978. Food business sales increased by 15.8%. Rising price levels, an increased number of customer transactions (+ 5.9%), increased food store square footage (+ 5.8%), and tonnage growth contributed to the sales improvement. Drug store sales increased over 1978 by 8.6%. Eighty-eight new food stores and 91 remodeled stores were completed while SupeRx added 38 drug stores.

In 1978, sales of $7.8 billion were 16% ahead of 1977. Food business sales were 17.4% higher due to the same factors that increased 1979 sales. Drug store sales declined slightly from 1977 as a result of closing 48 stores during the year.

In 1979, the Company changed from the retail and FIFO (First-In, First-Out) to the LIFO (Last-In, First-Out) method of valuing 66% of its inventories. Because of this change, earnings information for 1979 is furnished on both a LIFO and FIFO basis to enable a more meaningful comparison with the prior years.

Net earnings in 1979 were a record high, totalling $85,721,000 on a LIFO basis ($105,516,000 on a FIFO basis) compared to $84,596,000 (FIFO) in 1978. On a comparable accounting basis, this represents a 24.7% earnings increase. Earnings per share were $3.13 (LIFO) in 1979 compared to $3.11 (FIFO) in 1978. On a comparable FIFO basis for 1979, earnings per share increased to $3.85, up 23.8% over the prior year.

Food business operating profits in 1979 of $166.7 million (LIFO) compared unfavorably to $168.9 million (FIFO) in 1978. On a comparable FIFO basis, however, food business earnings in 1979 improved 20.4% from 1978. Drug store operating profits of $12.8 million in 1979 declined from $22.6 million earned in 1978. Increased advertising and inventory expenditures failed to produce the additional sales anticipated while other operating expenses increased.

In 1978, the Company's net earnings of $84.6 million represented a 40.9% increase over 1977, with food business operating profits improving 34.5% and drug stores operating profits improving 29.1%.

Merchandise costs, including warehousing and transportation, were 78.10% of sales in 1977, 77.72% in 1978 and 78.15% in 1979. The decrease of .38% in 1978 compared to 1977 was due to improvements in the margins of perishable departments and sales of products manufactured by the Company which typically carry higher than average margins. The increase of .43% in 1979 was created primarily by the 1979 change to LIFO accounting. In addition, while perishable gross margins continued to improve, other margins declined due to consumer resistance and selectivity arising from escalating cost increases and increased competitive pressures.

Operating, general and administrative expenses increased from 17.77% of sales in 1977 to 17.99% in 1978 and to 18.01% in 1979. These increases were the result of higher labor costs, payroll taxes and energy costs. Rent and depreciation and amortization rates decreased from 2.22% of sales in 1977 to 2.11% in 1978 and 2.04% in 1979 as the newer larger stores continued to mature and generate higher sales per square foot.

Taxes based on income were 41.5% of 1979 earnings before taxes on income compared to 44.8% in 1978 principally as a result of higher investment tax credits and a lower Federal tax rate.

Capital Expenditures

Capital expenditures for 1979 totaled $176,933,000 up from $114,504,000 in 1978. Expenditures in 1979 included $93,993,000 for retail stores and related equipment; $37,570,000 for food processing facilities and equipment; and $32,213,000 for vehicles and distribution facilities and equipment. Investment tax credits were $12,717,000 in 1979 compared to $9,614,000 in 1978. Capital expenditures for 1980 are projected to be $200,000,000, the major portion of of which will be spent on retail stores and related equipment.

Stock Split and Dividends

At the annual meeting held on April 12, 1979, shareowners approved a distribution in the nature of a two-for-one stock split. The additional shares were distributed on May 25. Adjusting for the split, dividends of $1.26 were paid in 1979 which marks the 78th consecutive year in which dividends have been paid out of current earnings. The quarterly dividend was increased four times in the period 1978-1979, from 20¢ to 22¢ per share in the second quarter of 1978, to 25¢ per share in the fourth quarter of 1978, to 29¢ per share in the first quarter of 1979 and to 34¢ per share in the third quarter of 1979. The regular quarterly dividend of 34¢ per share was paid on March 1, 1980 to owners of record February 1, 1980.

Quarterly Results

Sales for the fourth quarter of 1979 were $2,249,591,099 up 12.7% over the fourth quarter of 1978. In the fourth quarter of 1979 the Company changed to the LIFO method of valuing certain of its grocery inventories (See Notes to Consolidated Financial Statements). Earnings before taxes based on income for the fourth quarter of 1979 were $43,218,584 on a LIFO basis and $52,258,319 on a FIFO basis. Net earnings and earnings per share were $27,739,761 and $1.01 on a LIFO basis and $32,621,218 and $1.19 on FIFO basis. The effective tax rate for the fourth quarter varied from the statutory tax rate principally due to investment tax credits and a lower annual effective tax rate than previously anticipated. Quarterly sales, merchandise costs (including warehousing and transportation), net earnings and net earnings per share for 1979 and 1978 were as follows:

	Sales In Millions		*Merchandise Costs In Millions*		*Net Earnings In Millions*		*Net Earnings Per Share*		*Common Stock Price Range*	
Quarter	**1979**	1978	**1979**	1978	**1979(a)**	1978	**1979(a)(b)**	1978(b)	**1979(b)**	1978(b)
1st (12 weeks)...	**$1,927**	$1,675	**$1,504**	$1,306	**$15.5**	$12.4	**$ .57**	$ .46	**21⅛ - 17½**	14⅞ - 12¾
2nd (12 weeks)...	**2,061**	1,751	**1,607**	1,362	**22.7**	18.6	**.83**	.68	**20½ - 18¾**	17⅝ - 14⅜
3rd (16 weeks)...	**2,791**	2,406	**2,187**	1,868	**19.8**	23.5	**.72**	.86	**27 - 19⅝**	18⅜ - 15⅝
4th (12 weeks)...	**2,250**	1,996	**1,758**	1,548	**27.7**	30.1	**1.01**	1.11	**24¾ - 17⅝**	18½ - 15¾
	$9,029	$7,828	**$7,056**	$6,084	**$85.7**	$84.6	**$3.13**	$3.11		

(a) The change to the LIFO method of valuing inventories reduced net earnings in 1979 as follows:

	Net Earnings	*Net Earnings Per Share*
1st Quarter	$ 4,226,241	$.15
2nd Quarter	4,531,085	.17
3rd Quarter	6,156,258	.22
4th Quarter	4,881,457	.18
	$19,795,041	$.72

(b) Adjusted to reflect the two-for-one stock split approved by shareowners on April 12, 1979.

Segments of Business

The Company's segments of business information for the years 1975 through 1979 were as follows:

	1979	1978	1977	1976	1975
			(in millions of dollars)		
Sales:					
Food Business	**$ 8,462**	$ 7,306	$ 6,221	$ 5,678	$ 4,963
Drug Stores	**567**	522	527	505	458
Total	**$ 9,029**	$ 7,828	$ 6,748	$ 6,183	$ 5,421
Operating Profit:					
Food Business	**$ 166.7(a)**	$ 168.9	$ 125.6	$ 106.0	$ 83.7
Drug Stores	**12.8**	22.6	17.5	8.2	9.4
	$ 179.5	$ 191.5	$ 143.1	$ 114.2	$ 93.1
Unallocated Expenses:					
Corporate expenses, net	**$ 3.6**	$ 8.2	$ 5.8	$ 1.3	$ 8.8
Interest expense	**29.4**	30.0	30.6	27.7	25.4
	$ 33.0	$ 38.2	$ 36.4	$ 29.0	$ 34.2
Earnings before taxes based on income	**$ 146.5(a)**	$ 153.3	$ 106.7	$ 85.2	$ 58.9
Taxes based on income	**60.8**	68.7	46.7	37.3	24.8
Net earnings	**$ 85.7**	$ 84.6	$ 60.0	$ 47.9	$ 34.1
Identifiable Assets:					
Food Business	**$1,376.2**	$ 1,284.9	$ 1,133.4	$ 1,082.1	$ 993.6
Drug Stores	**204.5**	162.4	164.8	164.6	146.1
Other unallocated	**195.4**	205.7	230.5	198.6	162.3
Total assets	**$1,776.1**	$ 1,653.0	$ 1,528.7	$ 1,445.3	$ 1,302.0
Capital Expenditures:					
Food Business	**$ 155.4**	$ 108.0	$ 90.9	$ 78.3	$ 65.5
Drug Stores	**$ 10.9**	$ 4.2	$ 1.8	$ 2.8	$ 2.8
Depreciation and Amortization:					
Food Business	**$ 66.0**	$ 60.6	$ 56.7	$ 53.2	$ 51.7
Drug Stores	**$ 3.5**	$ 3.2	$ 3.2	$ 3.2	$ 3.0

(a) Food Business Operating Profit was reduced by $36.7 million as a result of the change from the FIFO method to the LIFO method of valuing grocery inventories.

Consolidated Statement of Earnings

Years Ended December 29, 1979 and December 30, 1978	**1979 (52 Weeks)**	1978 (52 Weeks)
Sales	**$9,029,314,683**	$7,828,071,073
Costs and Expenses:		
Merchandise costs, including warehousing and transportation	**$7,056,034,715**	$6,084,004,439
Operating, general and administrative expenses	**1,625,974,355**	1,407,959,372
Rent	**112,527,226**	99,784,836
Depreciation and amortization	**71,573,851**	65,179,454
Dividend and interest income	**(12,687,778)**	(12,096,623)
Interest expense, including interest on obligations under capital leases	**29,384,757**	29,983,188
Total	**$8,882,807,126**	$7,674,814,666
Earnings before taxes based on income	**$ 146,507,557**	$ 153,256,407
Taxes based on income	**60,786,738**	68,660,321
Net earnings	**$ 85,720,819**	$ 84,596,086
Average number of shares of common stock outstanding	**27,407,201**	27,208,058(a)
Net earnings per share of common stock	**$ 3.13**	$ 3.11

Consolidated Statement of Accumulated Earnings

Years Ended December 29, 1979 and December 30, 1978	**1979**	1978
Accumulated earnings – Beginning of the year	**$ 483,614,192**	$ 423,235,860
Net earnings for the year	**85,720,819**	84,596,086
	$ 569,335,011	$ 507,831,946
Dividends on common stock – $1.26 per share in 1979 and $ .89 per share in 1978	**(34,524,436)**	(24,217,754)
Accumulated earnings – End of the year	**$ 534,810,575**	$ 483,614,192

The accompanying notes are an integral part of the financial statements.
(a) Adjusted to reflect the two-for one stock split approved by shareowners on April 12, 1979.

Consolidated Balance Sheet

Assets	Dec. 29, 1979	Dec. 30, 1978
Current Assets		
Cash	$ 47,193,709	$ 28,467,068
Short-term investments, which approximate market	10,880,289	105,000,867
Receivables	79,883,492	78,170,579
Inventories	780,698,459	697,327,456
Store and general supplies	9,105,402	7,211,472
Prepaid and other current assets	33,067,607	27,711,028
Total current assets	$ 960,828,958	$ 943,888,470
Investments		
Marketable investment securities	$ 19,515,040	$ 19,866,739
Investments in and advances to unconsolidated companies	47,383,982	45,285,917
Other investments	4,939,155	4,914,328
Total investments	$ 71,838,177	$ 70,066,984
Property, Plant and Equipment		
Land	$ 28,058,579	$ 23,891,053
Buildings	149,572,524	126,664,587
Equipment	650,035,319	554,294,090
Leaseholds and leasehold improvements	205,106,523	183,534,784
Leased property under capital leases	137,270,501	133,274,483
	$1,170,043,446	$1,021,658,997
Allowance for depreciation and amortization	(444,823,843)	(400,367,454)
Property, plant and equipment, net	$ 725,219,603	$ 621,291,543
Other Assets		
Excess of cost of investments in consolidated subsidiaries over equities in net assets	$ 18,223,922	$ 17,782,070
Total Assets	$1,776,110,660	$1,653,029,067

Liabilities

	Dec. 29, 1979	Dec. 30, 1978
Current Liabilities		
Current portion of long-term debt	**$ 3,151,924**	$ 3,852,000
Current portion of obligations under capital leases	**3,056,664**	2,730,716
Accounts payable	**438,090,179**	397,294,520
Accrued expenses	**227,820,904**	194,792,043
Accrued federal income and other taxes	**41,079,247**	55,952,352
Total current liabilities	**$ 713,198,918**	$ 654,621,631
Other Liabilities		
Long-term debt	**$ 233,936,520**	$ 223,736,000
Obligations under capital leases	**106,054,750**	105,131,119
Deferred federal income taxes	**84,677,000**	86,244,000
Employees' benefit fund	**26,915,250**	28,789,251
Total other liabilities	**$ 451,583,520**	$ 443,900,370
Total Liabilities	**$1,164,782,438**	$1,098,522,001

Shareowners' Equity

Common capital stock, par $1, at stated value		
Authorized: 50,000,000 shares		
Issued 1979 – 28,038,187; 1978 – 27,842,106	**$ 94,749,364**	$ 91,897,801
Accumulated earnings	**534,810,575**	483,614,192
	$ 629,559,939	$ 575,511,993
Common stock in treasury, at cost – 1979 – 426,660 shares; 1978 – 580,454 shares	**(6,533,765)**	(9,658,091)
Net unrealized loss on marketable equity securities	**(11,697,952)**	(11,346,836)
Total Shareowners' Equity	**$ 611,328,222**	$ 554,507,066
Total Liabilities and Shareowners' Equity	**$1,776,110,660**	$1,653,029,067

The accompanying notes are an integral part of the financial statements.

Consolidated Statement of Changes In Financial Position

Years Ended December 29, 1979 and December 30, 1978	1979 (52 Weeks)	1978 (52 Weeks)
Sources of Working Capital		
From operations:		
Net earnings	$ 85,720,819	$ 84,596,086
Charges (credits) to earnings not involving funds:		
Depreciation and amortization	71,573,851	65,179,454
Provision for deferred federal income taxes	15,975,000	9,739,000
Gain on sale of subsidiary		(3,441,860)
Loss on marketable investment securities		4,006,860
Total from operations	$173,269,670	$160,079,540
Capital stock issued under option plans	1,951,966	1,236,757
Capital stock issued for acquisition	3,124,326	
Additions to long-term debt and obligations under capital leases	27,158,980	11,801,074
Reduction of marketable investment securities		7,488,070
Proceeds from sale of subsidiary		10,000,000
Net book value of fixed asset disposals	7,217,950	6,499,222
Total sources	$212,722,892	$197,104,663
Uses of Working Capital		
Cash dividends paid to shareowners	$ 34,524,436	$ 24,217,754
Capital expenditures	176,933,097	114,503,511
Increase in leased property under capital leases	3,996,018	11,801,074
Increase in investments in unconsolidated companies	1,961,226	2,329,900
Reduction of unredeemed trading stamps		26,926,973
Reductions of long-term debt and obligations under capital leases	16,034,829	17,903,844
Deferred taxes due resulting from change to LIFO	16,811,000	
Employees' benefit fund payments, net of provision	1,874,001	3,145,168
Other changes, net	2,225,084	1,167,077
Total uses	$ 254,359,691	$201,995,301
Net decrease in working capital	$ (41,636,799)	$ (4,890,638)

Analysis of Working Capital Changes

	Increase (Decrease)	
Current asset changes:		
Cash and short-term investments	$ (75,393,937)	$ (2,236,903)
Inventories	83,371,003	73,682,168
Other current assets	8,963,422	9,873,504
Net increase in current assets	$ 16,940,488	$ 81,318,769
Current liability changes:		
Current portion of long-term debt and obligations under capital leases	$ (374,128)	$ (3,524,939)
Accounts payable	40,795,659	55,402,778
Accrued expenses and taxes	18,155,756	61,258,541
Current portion of unredeemed trading stamps		(26,926,973)
Net increase in current liabilities	$ 58,577,287	$ 86,209,407
Net decrease in working capital	$ (41,636,799)	$ (4,890,638)

The accompanying notes are an integral part of the financial statements.

Accounting Policies

The following is a summary of the significant accounting policies followed in preparing the financial statements. These policies conform to generally accepted accounting principles and have been consistently applied except for the adoption of the LIFO method of inventory valuation in 1979.

Principles of Consolidation

The consolidated financial statements include the Company and all of its subsidiaries. Certain partially-owned affiliated companies are included in the financial statements on the equity basis. Certain amounts in the financial statements for 1978 have been reclassified to conform to the 1979 presentation.

Inventories

Inventories are stated at the lower of cost or market. In 1979, the Company changed its methods of accounting from the retail and first-in, first-out (FIFO) to the last-in, first-out (LIFO) method for approximately 66% of its inventories. LIFO inventories at December 29, 1979 were approximately $36,657,000 less than the amount of such inventories valued on a retail and FIFO bases. Cost for the balance of the inventories at December 29, 1979 and for all inventories at December 30, 1978 was determined by the retail and FIFO methods of inventory valuation. See note Accounting Change – Inventory.

Marketable Investment Securities

Marketable investment securities consist of bonds, notes, and common and preferred stocks held for investment. Dividend and interest income are accrued as earned. The cost of marketable investment securities sold is determined on the specific identification method.

Marketable equity securities (common and preferred stocks) are carried at the lower of cost or market. A valuation allowance, representing the excess of cost over market of these equity securities, is included in shareowners' equity. Other marketable investment securities (bonds and notes) are carried at cost unless there is a permanent impairment of value at which time the securities are valued at market. In management's opinion there is no indication of a permanent loss in value in the non-current portion of the portfolio and there is no present intention to liquidate the non-current securities at less than cost.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation and amortization, which include the amortization of assets recorded under capital leases, are computed principally on the straight-line basis. All maintenance and repairs are charged to earnings. Betterments and renewals which increase the value or productive capacity of assets are capitalized.

Excess of Cost of Investments in Consolidated Subsidiaries Over Equities in Net Assets

The excess of cost of investments in consolidated subsidiaries over equities in net assets at dates of acquisition originating prior to November, 1970 is not being amortized because, in the opinion of management, there has been no decrease in value. Amounts arising after October, 1970 are not significant and are being amortized on the straight-line basis over forty years.

Capitalization of Interest

Interest attributed to funds used to finance major capital expenditures is capitalized as an additional cost of the related assets. Capitalization of interest ceases when the related assets are substantially complete and ready for their intended use. The change to this policy was made in 1979 in accordance with Statement of Financial Accounting Standards No. 34 and had no material effect on net earnings or the overall financial statements.

Deferred Federal Income Taxes and Investment Tax Credit

Deferred federal income taxes include the amount of tax applicable to the excess of depreciation for tax purposes over depreciation used for financial reporting purposes less the amount of tax applicable to the unfunded pension liability and, in 1978, the amount of tax applicable to the change in 1973 from the LIFO (last-in, first-out) to the FIFO (first-in, first-out) method of inventory valuation.

Investment tax credits are included as reductions of income tax expense in the years in which the credits are used.

Accounting Change – Inventory

In 1979, the Company changed from the FIFO and retail methods of valuing certain of its grocery inventories to the LIFO method. The change in inventory valuation method was made to minimize inflation-induced inventory profits, to achieve a better matching of current costs with current revenues and to provide for greater comparability of the financial statements of the Company to those of other major companies in the supermarket industry.

The change to LIFO reduced net earnings in 1979 from $105,515,860 or $3.85 per share of common stock to $85,720,819 or $3.13 per share of common stock. Pro forma effects of retroactive application of LIFO are not determinable and there is no cumulative effect on accumulated earnings at December 30, 1978.

Marketable Investment Securities

Marketable investment securities include:

	1979	1978
Equity securities, at cost......	$30,360,280	$30,360,863
Less valuation allowance charged against shareowners' equity..	(11,697,952)	(11,346,836)
Equity securities, at market....	$18,662,328	$19,014,027
Bonds and notes, at cost.......	852,712	852,712
	$19,515,040	$19,866,739

The portfolio of equity securities included gross unrealized gains and losses of $634,533 and $12,332,485, respectively at December 29, 1979. Net realized losses included in earnings amounted to $4,006,860 in 1978. There were no realized gains or losses on marketable investment securities in 1979. The valuation allowance charged against shareowners' equity decreased $2,919,584 during 1978 compared to the previous year with $2,116,618 charged against earnings. The valuation allowance increased $351,116 during 1979.

Unconsolidated Companies

Investments in and advances to unconsolidated companies at December 29, 1979 include:

Amusement park joint ventures, at cost plus share of undistributed earnings since acquisition	$45,491,746
Other partially-owned affiliated companies, at cost plus share of undistributed earnings since acquisition	1,892,236
	$47,383,982

The Company has a 50% equity interest in joint ventures which are engaged in the operation of amusement parks. The Company's net earnings include the loss from amusement parks in the amount of $435,906 for 1979 and $101,581 for 1978.

Debt Obligations

Long-term debt at December 29, 1979 included:

9⅞% notes maturing in 1983	$ 50,000,000
9% sinking fund debentures maturing in 1995, with annual payments of $2,500,000 required from 1982 through 1995	32,122,000
8.70% sinking fund debentures maturing in 1998, with annual payments of $3,000,000 required from 1982 through 1998	50,949,000
8½% sinking fund debentures maturing in 2001, with annual payments of $2,500,000 required from 1982 through 2001	50,000,000
4½% to 9½% secured notes, annual payments due in varying amounts through 2004 (debt of real estate subsidiaries)	31,687,000
5.30% to 15½% notes, annual payments due in varying amounts through 2009	22,330,444
	$237,088,444
Less amount due within one year	(3,151,924)
	$233,936,520

Under certain of the loan agreements, payments of cash dividends are limited. Under the most limiting agreement, accumulated earnings were unrestricted in the amount of $238,000,000 at December 29, 1979.

Short-term borrowings of the Company averaged $3,890,000 and ranged up to $41,975,000 during 1979 at a weighted average annual interest cost of 14.6%.

Interest costs capitalized in 1979 amounted to $942,171.

Leases

The Company operates principally in leased premises. Lease terms generally range from ten to twenty-five years with options of renewal for additional periods. Options provide in some cases for reduced rentals and/or the right to purchase. Certain of the leases provide for contingent rental based upon a percent of sales.

Rent expense (under operating leases) for 1979 and 1978 consists of:

	1979	1978
Minimum rentals, net of minor sublease rentals	$101,903,974	$ 91,064,692
Contingent rentals	10,623,252	8,720,144
Total	$112,527,226	$ 99,784,836

Assets recorded under capital leases include:

	1979	1978
Distribution and manufacturing facilities	$ 96,578,801	$ 96,577,357
Store facilities	40,691,700	36,697,126
Less accumulated amortization	(36,883,772)	(32,766,704)
	$100,386,729	$100,507,779

Minimum annual rentals, net of subleased rentals which are minor in amount, for the five years subsequent to 1979 and in the aggregate are as follows:

	Capital Leases	Operating Leases
1980	$ 13,151,574	$ 105,364,178
1981	13,222,944	101,891,829
1982	13,221,189	98,519,956
1983	13,219,484	96,304,978
1984	12,815,142	93,634,245
1985 and thereafter	198,449,017	969,086,553
	$264,079,350	$1,464,801,739
Less estimated executory costs included in capital leases	(9,018,422)	
Net minimum lease payments under capital leases	$255,060,928	
Less amount representing interest	(145,949,514)	
Present value of net minimum lease payments under capital leases	$109,111,414	

Common Stock

Changes in common stock during 1978 and 1979 were as follows:

	Issued		Treasury	
	Shares	Amount	Shares	Amount
Balance, Dec. 31, 1977	27,704,252	$90,661,044	580,454	$9,658,091
Exercise of options	137,854	1,236,757		
Balance, Dec. 30, 1978	27,842,106	$91,897,801	580,454	$9,658,091
Exercise of options	196,081	1,951,966		
Treasury stock transaction		295,667	(153,794)	(3,124,326)
Tax benefit from exercise of nonqualified stock options		603,930		
Balance, Dec. 29, 1979	28,038,187	$94,749,364	426,660	$6,533,765

On April 27, 1979, following the approval by the shareowners of an amendment to the Company's Amended Articles of Incorporation which increased the authorized number of common shares to 50,000,000 with a par value of $1 per share, a distribution in the nature of a two-for-one stock split was made to common shareowners. All common shares and per share amounts, including common shares reserved for stock options, have been restated to reflect the stock split.

The treasury shares were issued in exchange for the minority interest of a subsidiary company. The excess of the fair market value over the cost of such shares at the date of issue has been credited to common stock.

Preferred Stock

The Company has authorized 750,000 shares of voting cumulative preferred stock which have a par value of $50 per share. None is outstanding at December 29, 1979.

Stock Option Plans

At December 29, 1979, options were outstanding to purchase 964,323 shares of common stock under the 1965, 1969 and 1976 Stock Option Plans (of which options on 642,657 shares were exercisable at that date) at prices ranging from $7.78 to $25.06 a share. Each option outstanding was granted at an option price equal to the fair market value of the stock at the date of grant. No further options may be granted under the 1965 and 1969 Plans. Options may be granted under the 1976 Plan until 1986. At December 29, 1979, shares of common stock available for future options under the 1976 Plan amounted to 290,108 shares.

Changes during 1979 in options outstanding under the Stock Option Plans of the Company were as follows:

	Shares Subject To Option	Option Price Range Per Share
Outstanding December 30, 1978	1,085,804	$ 7.78 - $16.53
Granted	104,000	$17.94 - $25.06
Exercised	(196,081)	$ 7.78 - $17.94
Cancelled or expired	(29,400)	$ 9.60 - $17.94
Outstanding December 29, 1979	964,323	$ 7.78 - $25.06

See Common Stock note regarding stock split.

Pension Plans

The Company has three noncontributory retirement plans for eligible employees, two of which have historically been funded. The third retirement plan, which was previously unfunded, is being funded over a period of forty years. The Company also contributes to multi-employer plans jointly administered by management and union representatives.

The actuarially computed value of vested benefits for the Company administered plans as of December 29, 1979 exceeded the total of the pension funds and balance sheet accruals by approximately $44,460,000. Past service costs of the Company's plans are amortized over forty years.

The total pension expense for all plans for 1979 and 1978 was $71,882,168 and $59,082,048, respectively.

Taxes Based On Income

The provision for taxes based on income consists of:

	1979	1978
Federal		
Current	$29,625,000	$47,616,000
Deferred	15,975,000	9,739,000
	$45,600,000	$57,355,000
State and Local		
Current	15,186,738	11,305,321
Total	$60,786,738	$68,660,321

The provision for taxes based on income is lower than the normal statutory corporate tax rate principally due to investment tax credits which reduced the tax provision by $12,717,000 in 1979 and $9,614,000 in 1978.

In 1973, the Company discontinued the LIFO method of valuing inventories and received Internal Revenue Service permission to spread the tax liability resulting from the change over a twenty year period. As a result of readopting the LIFO method of valuing inventories during 1979, deferred taxes, amounting to $16,811,000, became currently payable at December 29, 1979.

Litigation

There are pending against the Company various claims and lawsuits arising in the normal course of business including, as of December 29, 1979, suits charging violations of certain antitrust and civil rights laws. Some of these suits purport or have been determined to be class actions and/or seek damages in very large amounts. Any damages that may be awarded in antitrust cases will be automatically trebled.

Sixteen antitrust suits alleging, among other things, price-fixing in the purchase and sale of meat, have been consolidated for pretrial and discovery purposes in the United States District Court in Dallas. On December 27, 1977, the Court entered a judgment dismissing nine of these suits which had been filed in 1975 and 1976. Appeals were filed in eight of the dismissed suits. The Fifth Circuit Court of Appeals reversed the dismissals and remanded the cases for further proceedings. A petition for rehearing was filed and is now pending. No appeal was filed in the ninth suit, but a similar suit was filed in California under state antitrust statutes. That case was dismissed, and an appeal from such dismissal has been taken. The complaints in the remaining seven suits, which were filed in 1977, include certain allegations not contained in the earlier filed suits. Since discovery has been very limited, and since each of the suits, if tried at all, may go to a jury, the Company cannot predict their ultimate outcome. The Company believes, however, that it has substantial defenses available and should prevail in all.

Although the amount of liability at December 29, 1979 with respect to all claims and lawsuits cannot be ascertained, the Company is of the opinion that any resulting liability will not have a material effect upon the Company's financial position.

Segments of Business

The Company's segments of business information for 1979 and 1978 are included on page 16.

Quarterly Financial Data (Unaudited)

Quarterly sales, merchandise costs, net earnings and net earnings per share of common stock for 1979 and 1978 are presented on page 15.

Changing Prices (Unaudited)

The Company's information regarding the impact of changing prices on a constant dollar basis is presented on pages 25 and 26. As required by the Securities and Exchange Commission, current replacement cost information for certain assets and certain costs and expenses are to be disclosed in the Company's Form 10-K with the Commission.

The current replacement cost of the Company's affected inventories and productive capacity and the amount of the associated merchandise costs and depreciation expense calculated using replacement costs are generally higher than the comparable historical cost amounts shown in the financial statements.

Report of Certified Public Accountants

To the Shareowners and Board of Directors
The Kroger Co.

We have examined the consolidated balance sheets of The Kroger Co. and Consolidated Subsidiary Companies as of December 29, 1979 and December 30, 1978, and the related consolidated statements of earnings, accumulated earnings and changes in financial position for the fiscal years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of The Kroger Co. and Consolidated Subsidiary Companies at December 29, 1979 and December 30, 1978, and the consolidated results of their operations and changes in their financial position for the fiscal years then ended, in conformity with generally accepted accounting principles applied on a consistent basis except for the change, with which we concur, in the method of valuing inventories as described in Notes to Consolidated Financial Statements.

Coopers & Lybrand
3800 Carew Tower
Cincinnati, Ohio 45202.
February 14, 1980

Coopers & Lybrand

A copy of the Company's 1979 report to the Securities and Exchange Commission, Form 10-K, is available to shareowners on request by writing: Irle R. Hicks, Treasurer, The Kroger Co., 1014 Vine Street, Cincinnati, Ohio 45201.

The annual meeting of shareowners will be held at the Corbett Tower, Music Hall, 1243 Elm Street, Cincinnati, Ohio, on April 10, 1980, at 10 a.m.

Transfer Agent and Registrar

The First National Bank
111 East Fourth Street
Cincinnati, Ohio 45202
Telephone: 513-852-4648

New York Stock Exchange Listing – Symbol KR.

Introduction to Inflation Financial Statements

During the past 10 years, the United States has experienced rapid inflation as contrasted to the relatively low level of inflation existing in prior years. Continued inflation over time distorts traditional accounting measurements of earnings and capital. In an effort to produce financial information that discloses the effects of inflation, the Financial Accounting Standards Board (FASB) has issued Statement No. 33, Financial Reporting and Changing Prices, requiring companies to explain the effect of inflationary factors on their operations by adjusting historical financial statements for the effects of changing prices.

The accompanying statement of earnings and five-year summary of selected data were prepared to reflect these inflationary factors in accordance with Statement 33.

Statement 33 requires that the effect of general inflation on operations be measured by the Consumer Price Index for All Urban Consumers (CPI-U). This measure of inflation encompasses a wide range of commodities and thus is not necessarily representative of the inflation effect upon our business.

The following adjusted statement of earnings has been prepared using the CPI-U index to restate merchandise costs and depreciation expense in terms of average 1979 (constant) dollars. Shown also is a five-year summary of selected financial data, restating merchandise costs and depreciation expense in the same manner and converting the other elements used to arrive at net earnings and net assets into average 1979 dollars. Net assets represent the shareowners equity of the Company which has increased after the adjustment to revalue inventory and net property, plant and equipment for general inflation.

The gain from the decline in purchasing power of net amounts owed is primarily attributable to the debt which has been used to finance inventories and capital expenditures. During a period of inflation, holders of monetary assets suffer a loss of general purchasing power, while holders of monetary liabilities experience a gain. Since the monetary liabilities at each year-end were larger than the monetary assets, an unrealized gain results. The gain will not be realized, however, until the liabilities are paid in the future with dollars of less purchasing power.

Consolidated Statement of Earnings Adjusted for General Inflation

For The Year Ended December 29, 1979 (52 Weeks)
(in thousands of dollars)

	As Reported In The Primary Statements	*Adjusted For General Inflation*
Sales	$9,029,000	$9,029,000
Costs and expenses:		
Merchandise costs, including warehousing and transportation	$7,056,000	$7,084,000
Operating, general and administrative expenses	1,626,000	1,626,000
Rent	113,000	113,000
Depreciation and amortization	71,000	95,000
Dividend and interest income	(13,000)	(13,000)
Interest expense, including interest on obligations under capital leases	29,000	29,000
Total	$8,882,000	$8,934,000
Earnings before taxes based on income	$ 147,000	$ 95,000
Taxes based on income	61,000	61,000
Net earnings	$ 86,000	$ 34,000
Gain from decline in purchasing power of net amounts owed		$ 108,000

Five-Year Comparison of Selected Supplementary Financial Data Adjusted for Effects of General Inflation

(thousands of average 1979 dollars, except per share figures)

	1979	1978	1977	1976(a)	1975
Sales	$9,029,000	8,709,000	8,082,000	7,884,000	7,311,000
Constant Dollar Data:					
Net earnings (loss)	$ 34,000	12,000	8,000	7,000	(20,000)
Net earnings (loss) per share of common stock	$ 1.24	.44	.29	.25	(.74)
Net assets at year end	$ 954,000	858,000	817,000	783,000	764,000
General Information:					
Gain from decline in purchasing power of net amounts owed.	$ 108,000	74,000	54,000	39,000	56,000
Dividends per share	$ 1.26	.99	.91	.88	.92
Market price per share at year end	$ 17.500	19.125	16.125	14.875	11.750
Average consumer price index	217.4	195.4	181.5	170.5	161.2

(a) Fifty-three weeks

Notes to Supplementary Data on Changing Prices

Accounting Policies

The supplementary data on changing prices is based upon the historical financial statements as reported in the primary financial statements adjusted for general inflationary factors relating to property, plant, and equipment and inventories.

Depreciation expense was calculated using the same methods and rates of depreciation as used in the historical financial statements.

Income tax expense has not been modified for any timing differences, allocations or adjustments that may result from applying the different methods in preparing the supplementary data.

No attempt has been made to calculate the benefit derived from additional realization of selling price increases necessitated by a higher level of cost of operations resulting from the application of the constant dollar adjustments to the original historical cost of property, plant and equipment and inventories.

Constant Dollars

The supplementary data on a constant dollar basis is expressed in average for the year dollars and reflects adjustments that have occurred in the purchasing power of the dollar as measured by the Consumer Price Index for All Urban Consumers (CPI-U) published by the Bureau of Labor Statistics. These amounts do not purport to represent appraised values or any other measure of current value.

Five Year Summary

Operations

(thousands of dollars, except per share figures)

		1979	1978(b)	1977(b)	1976(a)(b)	1975(b)
Sales	$	**9,029,315**	7,828,071	6,747,553	6,182,991	5,421,296
Costs and Expenses	$	**8,882,807**	7,674,815	6,640,881	6,097,816	5,362,417
Earnings before Taxes						
Based on Income	$	**146,508**				
Before effect of LIFO	$	**183,165**	153,256	106,672	85,175	58,879
Taxes Based on Income	$	**60,787**				
Before effect of LIFO	$	**77,649**	68,660	46,649	37,250	24,822
Net Earnings	$	**85,721**				
Before effect of LIFO	$	**105,516**	84,596	60,023	47,925	34,057
Dividends	$	**34,524**	24,218	20,551	18,577	18,298
Per Share						
Net Earnings	$	**3.13**				
Before effect of LIFO	$	**3.85**	3.11	2.22	1.78	1.26
Dividends	$	**1.26**	.89	.76	.69	.68

Balance Sheet Statistics

(thousands of dollars, except per share figures)

		1979	1978(b)	1977(b)	1976(a)(b)	1975(b)
Inventories	$	**780,698**	697,327	623,645	558,347	500,110
Working Capital	$	**247,630**	289,267	294,157	298,528	216,524
Property, Plant and Equipment, net	$	**725,220**	621,292	570,989	544,472	534,979
Total Assets	$	**1,776,111**	1,653,029	1,528,721	1,445,302	1,302,049
Long-Term Debt	$	**233,937**	223,736	238,892	259,561	213,085
Shareowners' Equity	$	**611,328**	554,507	489,972	455,273	423,721
Per Share of Common	$	**22.14**	20.34	18.06	16.85	15.71

Other Statistics

(dollars and shares in thousands)

		1979	1978(b)	1977(b)	1976(a)(b)	1975(b)
Capital Expenditures	$	**176,933**	114,504	96,417	81,906	70,161
Depreciation and Amortization	$	**71,574**	65,179	61,394	57,294	55,251
Rent	$	**112,527**	99,785	88,363	82,611	74,632
Interest Expense	$	**29,385**	29,983	30,626	27,713	25,438
Dividend and Interest Income	$	**12,688**	12,097	8,467	7,327	5,000
Common Shares Outstanding		**27,612**	27,262	27,124	27,013	26,978
Number of Shareowners		**37,849**	37,413	40,123	42,508	44,941

Retail Facilities

(areas in thousands of square feet)

	1979	1978(b)	1977(b)	1976(a)(b)	1975(b)
Food Stores					
Opened	**88**	104	98	90	71
Remodeled	**91**	58	35	33	40
Closed	**56**	90	83	137	92
Stores – End of Year	**1,234**	1,202	1,188	1,173	1,220
Total Area	**32,460**	30,673	28,642	26,850	26,415
Drug Stores					
Opened and Acquired	**38**	7	11	20	56
Closed	**21**	48	41	13	27
Stores – End of Year	**504**	487	528	558	551
Total Area	**5,657**	5,591	6,108	6,399	6,234

(a) Fifty-three weeks

(b) Adjusted to reflect the two-for-one stock split approved by shareowners on April 12, 1979.

Directors

William D. Atteberry, *Chairman of the Board and Chief Executive Officer, Eagle-Picher Industries, Inc.*
Philip E. Beekman, *President, Joseph E. Seagram & Sons, Inc.*
Raymond B. Carey, Jr., *Chairman of the Board and President, American District Telegraph Company*
Lyle Everingham, *Chairman of the Board, President and Chief Executive Officer*
James P. Herring, *Former Chairman of the Board*
Jackson C. Hinds, *Chairman of the Board and Chief Executive Officer, Entex, Inc.*
Patricia Shontz Longe, *Professor, Business Administration University of Michigan*
T. Ballard Morton, Jr., *President, Orion Broadcasting, Inc.*
Thomas H. O'Leary, *President, Missouri Pacific Corporation*
John D. Ong, *Chairman, President and Chief Executive Officer, The B. F. Goodrich Company*
W. George Pinnell, *Executive Vice President, Indiana University*
R. Nelson Shaw, *Former Chairman, Mercantile Stores Company, Inc.*
Edward D. Smith, *Of Counsel, Hansell, Post, Brandon & Dorsey, Atlanta Attorneys*
Morley P. Thompson, *President, Baldwin-United Corporation*
Russell L. Wagner, *Chairman of the Board and Chief Executive Officer, NLT Corporation*

Corporate Officers

Raymond F. Abaray, *Vice President*
Robert W. Braunschweig, *Vice President*
John A. Cornett, *Senior Vice President*
Lyle Everingham, *Chairman of the Board, President and Chief Executive Officer*
Irle R. Hicks, *Treasurer*
Arthur Juergens, *Vice President*
William G. Kagler, *Senior Vice President*
George W. Keith, *Vice President President, SupeRx Drug Stores*
Richard M. Koster, *Group Vice President*
George A. Leonard, *Vice President Secretary and General Counsel*
William W. Oliver, *Group Vice President*
Robert E. Saffron, *Vice President*
William J. Sinkula, *Vice President*
John L. Strubbe, *Group Vice President*
Charles L. Thomas, *Group Vice President*

Operating and Staff Vice Presidents

Corporate Staff

Stuart M. Berman, *Planning*
Carl W. Brieske, *Tax Counsel*
F. Leland Davis, *Community Development*
Paul A. Gibson, *Personnel*
Don A. Hirsch, *Labor Relations*
Jack G. Hudson, *Controller*
Lorrence T. Kellar, *Capital Management*

Kroger Food Stores

Headquarters Staff

R. Gus Bublitz, *Advertising*
Robert L. Cottrell, *Distribution Administration*
Bobbie L. Criswell, *Distribution Operations*
Donald F. Dufek, *Store Operation Services*
Richard W. Goff, *Meat Plant Operations*
J. Wayne Harris, *Produce Merchandising*
Dean A. Hicks, *Marketing Administration*
George L. Irwin, *Delicatessens/Bakeries*
Thaddeus J. Kaczmarowski, *Facility Engineering*
Adrian L. Vannice, *Grocery Merchandising*

Marketing Areas

Richard L. Bere, *Columbus*
Newton W. Briggs, *Dallas*
David A. Burt, *Michigan*
Walter R. Dryden, *Southland*
Theodore Engel, *Central*
Robert G. Everingham, *Houston*
Joel E. Greenisen, *Louisville*
Robert L. Hayden, *Market Basket*
James A. LeRoy, *Delta*
Robert E. Saffron, *Cincinnati*
Nerville A. Sawall, *Gateway*
Richard D. Schill, *Carolinas*
Edwin A. Sieveking, *Mid-Atlantic*
Gerald L. Wolken, *Erie*

Kroger Manufacturing

Marshall H. Gooch, *Personnel*
George M. Laughlin, *Grocery Products Division*
William R. Pugh, *Baked Foods Division*
Ronald R. Rice, *Dairy Foods Division*
William Harold Wall, *Poultry & Egg Division*
Robert M. Williams, *Research and Developmental Engineering*
Len L. Witt, *Procurement*

SupeRx Drug Stores

Headquarters Staff

Clyde N. Ballsrud, *Real Estate*
Frank Corella, *Merchandising*
Henry J. Fitzgerald, *Optical*
Albert G. Harsnett, *Advertising*
Gary E. Hendren, *Marketing*
William J. Howe, *Administration Services*
William J. Johnson, *Business Planning*
Norbert J. Panko, *Controller*
Walter W. White, *Operating Services*

Retail Operations

Ronald R. Baumgarth, *North East Region*
Dennis O Curran, *Florida Region*
Augustus E. McPhaul, *South East Region*
Larry E. Slade, *North Central Region*

369

The Kroger Co.

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